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THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS

Summary

There is increasing frustration with the apparent inability of the General Agreement on Tariffs and Trade to stem the rising tide of protectionism and resolve trade disputes. Trade in major products, such as cars and steel, is increasingly restricted by bilateral agreements that violate GATT principles. The GATT secretariat has identified 94 recent voluntary export restraint or market-sharing arrangements that are inconsistent with the organization's rules. Although GATT's 93 member-countries account for more than 80 percent of world trade, only 20 percent of total trade is conducted under GATT rules, according to one study.

The Uruguay Round, launched in September 1986, offers an important opportunity to improve the world trading system. The 15 topics for negotiation include measures to make the GATT more effective, particularly in its ability to settle disputes. The most contentious issues are likely to be trade in agricultural products and the extension of GATT coverage to services. The developing countries, particularly the newly industrialized countries of Asia, are likely to play a more important role in the new round, reflecting their growing share of trade in manufactured goods.

Launching the Uruguay Round

The major incentive for the new round of multilateral trade negotiations is the prospect of obtaining the growth-promoting benefits of increased trade by lowering trade barriers. Although the value of world merchandise trade

increased 10 percent last year to top the $2 trillion mark for the first time (see Table 1), this largely reflects the decline in the dollar that boosted the value of other countries' exports. The increase was much less in volume terms. Trade in manufactured goods rose 3 percent, "one of the poorest performances in three decades," according to GATT, while the volume of agricultural trade increased only 1 percent. In contrast, trade in fuels and mining products rose 7 percent, boosted by a sharp decline in petroleum prices.

Table 1: World Exports, 1950-84

(in billions of dollars)

Year	Developed Countries	Developing Areas	Eastern Trading Areas*	Total
1963	$100	$33	$18	$155
1968	160	46	26	238
1973	401	103	57	574
1975	568	194	92	875
1980	1,354	463	172	1,989
1981	1,285	507	171	1,963
1982	1,197	476	171	1,844
1983	1,187	442	180	1,808
1984	1,284	436	187	1,907
1985	1,275	441	206	1,922
1986	1,480	400	230	2,110

*Eastern Europe, the USSR, China and other centrally planned economies in Asia.

Source: General Agreement on Tariffs and Trade, International Trade 1985/86.

On September 20, 1986 representatives from 74 countries met at the annual GATT ministerial meeting in Punta del Este, Uruguay and agreed to launch the new round. The ministerial declaration called for negotiations on 14 topics to "halt and reverse protectionism," and agreed to begin talks on services trade on a separate track from trade in goods. The communique also included standstill and rollback commitments on trade restrictions under which governments pledged not to take any trade restrictive measures that were inconsistent with GATT principles, and agreed to phase out existing breaches of GATT rules.

In January 1987 trade officials from member countries agreed to a timetable and program for the new round. Fifteen negotiating groups have been established to outline the issues so that actual bargaining can begin in 1988. The talks are slated to last four years, although early agreements may be possible in some areas. The negotiating topics can be divided into four

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categories: measures to strengthen the role of GATT; revisions of existing agreements; issues of concern to developing countries; and the extension of GATT coverage to new areas.

Measures to Strengthen the Role of GATT

One of the negotiating committees will consider possible changes in existing GATT articles and provisions. A second committee on the functioning of the GATT system will consider proposals to enhance the surveillance of national trade policies as a means of insuring compliance with trading rules. In light of the connection between finance and trade, it will also examine ways to strengthen the links between GATT and the International Monetary Fund and the World Bank.

GATT's inability to resolve disputes, one of the organization's most glaring weaknesses, is a major issue. For instance, in 1982 the United States complained that the European Community unfairly restricted imports of U.S. oranges and lemons. A GATT panel ruled in favor of this country in 1985, but the EC ignored the ruling and blocked the report's adoption. The issue was finally resolved in bilateral talks between the United States and the EC in September 1986.

This incident is typical of the dispute-settlement procedure since GATT does not have sufficient authority to impose a solution. The difficulty of interpreting vague rules also complicates the resolution of disputes. Under the dispute-settlement procedure of Article 23, any member country can file a complaint alleging a violation of GATT rules. If bilateral negotiations fail to produce an agreement, a panel of experts is then established to judge the case. Since the member countries decide by consensus whether to accept the report, the alleged violator has the power to veto any recommendation -- a procedure that has been compared to having a policeman without a jail.

GATT's inability to enforce recommendations has encouraged countries to settle problems outside the system -- settlements that are often GATT-illegal, trade restrictive and damaging to third-country interests. U.S. Trade Representative Clayton Yeutter argues that GATT will "ultimately fade into oblivion" unless it can settle trade disputes more effectively and swiftly. Washington favors a "binding arbitration" approach. If the offending country failed to abide by the ruling, it would at least have to provide compensation.

It is unlikely, however, that the implementation of tougher rules will substantially improve the dispute-settlement process. GATT is limited by the level of political commitment that governments choose to invest in it. Many countries continue to prefer bilateral negotiations to solve trade problems, implying that the issues are too important to be left to the GATT. Until countries develop the political will to submit to GATT discipline, the dispute-settlement process will continue to be ineffective.

Revision of Existing Agreements

One of the 15 committees in the new round will attempt to improve, clarify and expand the agreements on nontariff barriers reached in the Tokyo Round (1973-79). Seven codes cover government procurement, standards, customs valuation, import licensing, dumping, domestic and export subsidies and civil

aircraft. Negotiations on the government procurement code, which is aimed at preventing central governments from discriminating against foreign goods, led to an agreement last November on an expanded code.

The reduction or elimination of tariffs will be discussed by another negotiating group. Although tariff levels have been greatly reduced, they remain a significant barrier to trade in some important products. U.S. objectives in this area include reducing tariffs on products such as chemicals and furniture, as well as a reduction in the high import levies that prevail in many developing countries.

Also on the agenda is the issue of subsidies and countervailing duties. When a production or export subsidy leads to the injury of an industry in the importing country, the government has the right to impose countervailing duties to offset the economic effect of the subsidy. The committee will seek to improve the subsidies code negotiated during the Tokyo Round that governs the use of both subsidies and countervailing duties.

The negotiating committee on nontariff measures will seek to reduce or eliminate nontariff barriers to trade, including quantitative restrictions. Although GATT Article 11 prohibits the use of quotas except for agricultural commodities in certain situations, it is often violated. Domestic producers prefer the greater certainty of quotas, which better insulate them from market forces. Tariffs, however, permit goods to be imported from the cheapest source and also provide the government with revenue. Under quotas, in contrast, foreign producers receive monopoly profits (unless the quota rights are auctioned), creating incentives for the perpetuation of the quotas.

Safeguards remain a major unresolved issue. Article 19 of the GATT allows temporary safeguards to protect industries that are found to be seriously injured by imports. The rules require prior notification and the affected countries can retaliate in response if they are not provided compensation. In addition, Article 19 is generally interpreted to mean that the restrictions should be temporary and applied in a nondiscriminatory fashion against the supplying countries. One recent example was Washington's 1983 imposition of quotas and higher tariffs on specialty steel under Section 201 of the Trade Act of 1974. The European Community retaliated by restricting imports of sports equipment and some chemical products from this country.

The rapid shift of comparative advantage among countries and the excess capacity that exists in many industries has resulted in intense pressure to restrict imports. Article 19 has gradually fallen into disuse as countries have increasingly relied on bilateral measures, such as voluntary restraint agreements and orderly marketing agreements, to protect domestic industries. The EC, for example, has negotiated 15 bilateral agreements restricting steel imports since 1978; the United States has signed 18 such accords since 1984. These pacts violate the principle of non-discriminatory behavior by allowing selective protectionism. A significant number of bilateral agreements initiated in recent years restrict imports from Japan and the newly industrialized countries in Asia (Korea, Taiwan, Hong Kong and Singapore). According to a study by the Organization for Economic Cooperation and Development, the value of manufactured exports from Japan and the NICs subject to trade restrictions by OECD countries increased from $14.9 billion in 1980 to $31.7 billion in 1983.[1]

The increased use of these "grey area" measures is a major cause of the decline in GATT's prestige and effectiveness. There are two basic reasons for the virtual breakdown of the safeguard system. First, the stringent requirements of Article 19 make it unattractive. Using grey area measures, a country has no obligation to prove that imports have caused serious injury. Moreover, it can single out countries for restraints and does not have to provide compensation. Second, measures consistent with GATT rules are unlikely to resolve the difficulties of declining industries affected by falling demand or a shift in comparative advantage to other producers.

Although grey area measures may be no more severe than safeguard actions, they are potentially more troublesome for several reasons. Bilateral restraints generally penalize the most efficient producer and new market entrants, often developing countries. Furthermore, these restraints are easier to initiate and maintain since the affected countries have no recourse. It is important, therefore, that GATT principles be applied to temporary import restraints to provide fairness and discipline.

A successful safeguards code would require members to sacrifice some of their economic sovereignty by allowing GATT more control over politically sensitive issues. A code should include both incentives and sanctions to persuade countries to adhere to GATT principles in taking future safeguard actions. It would be useful if the GATT secretariat had a role in designing and monitoring import restraint programs, similar to the IMF's role in debt negotiations. Statistical standards should be established to determine whether the injury is serious enough to justify restraints. Import restrictions should take the form of tariffs that decline over time. Since in most cases the injured industry has lost international competitiveness, the restraint program should foster contraction rather than revival. Moreover, it should not commit public funds to the industry or mandate private investment in that field.

The failure to negotiate a safeguards code was one of the major failures of the Tokyo Round. The question of whether to allow safeguard actions to be imposed on targeted countries rather than on a nondiscriminatory basis prevented agreement. The EC's position is that countries should be able to target those nations causing the injury, while not restricting imports from traditional suppliers. Developing countries, which fear that selective measures would discriminate against them, do not concur. A new code should prohibit selectivity because it lowers the cost of safeguard action and makes protection too easy.

Issues of Concern to Developing Countries

GATT has long been dominated by the problems and interests of the United States, Western Europe and Japan. Developing countries are presently accorded "special and differential" treatment under Part 4 of the GATT through preferences and easier access to exemptions, and are not required to make reciprocal concessions in negotiations. Actually, this special treatment is of limited value since GATT has neglected many important issues of concern to the third world. Since the developing countries were not required to grant reciprocal concessions to the industrialized countries, they received little in return.

In the Uruguay Round the developing countries will be expected "to participate more fully in the framework of rights and obligations under the

General Agreement," according to the Punta del Este declaration. Many countries argue that the LDCs should accept more of the responsibilities of membership commensurate with their increased share of world trade. Several developing countries, such as Taiwan and South Korea, have become major exporting nations (see Table 2). As a group, the third world's share of world trade in manufactures rose from 6.9 percent in 1973 to 12.4 percent in 1985 (see Table 3). Since some have reached a level of income that no longer warrants special treatment, the question of when developing countries should "graduate" from special trade preference should be addressed. By 1986, for example, South Korea's gross domestic product per capita had overtaken Turkey and was gaining fast on Portugal.

Table 2: The 20 Leading Exporting Nations, 1973 and 1985

Country	Share of World Exports 1973	Share of World Exports 1985	1973 Rank
United States	12.5%	10.7%	1
West Germany	11.8	9.6	2
Japan	6.4	9.1	3
United Kingdom	5.2	5.3	5
France	6.3	5.1	4
Soviet Union	3.7	4.5	10
Canada	4.4	4.5	6
Italy	3.9	4.1	9
Netherlands	4.2	3.6	7
Belgium-Luxembourg	3.9	2.8	8
Taiwan	0.8	1.6	27
Sweden	2.1	1.6	11
Hong Kong	0.9	1.6	24
South Korea	0.6	1.6	39
China	1.0	1.4	20
Switzerland	1.7	1.4	12
Saudi Arabia	1.6	1.4	14
Brazil	1.1	1.3	17
East Germany	1.3	1.3	16
Spain	0.9	1.3	23

Source: General Agreement on Tariffs and Trade

The question of tariff escalation (see Table 4), which limits the development of processing industries in raw material-supplying (mainly less developed) countries and encourages them to remain "hewers of wood and drawers of water," will be discussed by the negotiating committees on tropical products and natural resource-based products. While tropical products, such as coffee, tea, cocoa, tropical wood and rubber, do not represent a large share of world trade, many developing countries rely heavily on them for export earnings. LDCs want lower barriers to these products, both in their processed and unprocessed forms. A reduction of trade barriers to natural resource-based products will promote industrial development in many third world countries.

Table 3: Ten Leading LDC Exporters of Manufactured Goods

(in billions of dollars)

Country	Value		Share of World Total	
	1973	1985*	1973	1985*
Taiwan	$3.7	$27.8	1.1%	2.3%
South Korea	2.7	27.7	0.8	2.3
Hong Kong	4.7	27.3	1.4	2.3
Brazil	1.2	15.5	0.3	1.3
Singapore	1.6	11.7	0.5	1.0
India	1.6	4.8	0.5	0.4
Malaysia	0.3	3.9	0.1	0.3
Thailand	0.2	2.4	0.1	0.2
Argentina	0.7	1.4	0.2	0.1
Philippines	0.2	1.2	0.1	0.1
LDC Total	24.0	149.0	6.9	12.4

*Preliminary estimates.

Source: General Agreement on Tariffs and Trade

Table 4: Average Tariff Levels in Major OECD Countries, 1983

	United States	Japan	Canada	European Community
Finished Manufactures	6.9%	6.4%	8.1%	7.0%
Semifinished Manufactures	6.1	6.3	6.6	6.2
Raw Materials	1.8	1.4	2.6	1.6

Source: G.C. Hufbauer and J.J. Schott, Trading For Growth: The Next Round of Trade Negotiations (Washington, D.C.: Institute for International Economics, 1985), p. 77.

Another category of particular concern to the developing world is trade in textiles and apparel, an area largely exempt from GATT rules. Quantitative restrictions have been imposed on cotton textiles since 1961. The Multi-Fiber Arrangement, first negotiated in 1974, was renewed for five years in August 1986 and serves as the framework for bilateral restraint agreements among 50 nations covering products made from cotton, wool, synthetics and all natural fibers except pure silk. Although developed countries generally do not apply quotas against each other, the MFA is a costly policy; one study estimates that

it raises clothing prices in Great Britain by 20 to 50 percent. The World Bank estimated that in 1980 the cost of each job saved in the American and European clothing industries by protectionist measures was $169,600 and $124,700, respectively.[2] At the same time, trade restrictions have failed to prevent a decline in employment in the textile and clothing industries in the developing countries (see Table 5).

Table 5: Change in Employment in Textiles and Clothing, 1973-84

(percentage change over period)

	Textiles	Clothing
United States	-22%	-18%
Canada	-25	-20
European Community	-46	-43
Austria	-43	-27
Sweden	-41	-56
Switzerland	-37	-51

Source: General Agreement on Tariffs and Trade

Although some smaller producers enjoy the security of quotas under the MFA, many developing countries have called for freer trade in textiles and apparel, which account for about one-fourth of their manufactured exports. Despite the renewal of the MFA, one committee will consider textile-apparel trade. While the ultimate goal should be free trade, it is politically impossible and would entail severe dislocations after so many years of protection. A more viable solution is to return textiles and apparel to GATT rules through a gradual phaseout of the MFA during the next 10 years. A compromise on textiles and apparel may help integrate the developing countries into the mainstream of GATT.

Another concern to the developing countries is the question of intellectual property rights. The United States believes an agreement is crucial to protect U.S. technology in such areas as computer software and semiconductors. Counterfeit goods make up an estimated $60 billion in annual world trade. Washington is hoping for a code to provide effective protection for intellectual property rights, including patents, copyrights and trademarks, within the GATT framework. As a first step, negotiators are seeking early approval of an agreement to stop trade in counterfeit goods. Border controls alone are insufficient since a growing share of intellectual property is transmitted via telephone or satellite. Washington contends that a code protecting these rights would benefit developing countries by encouraging technology transfers and direct investment. The negotiations, however, have been slowed by the strong objections of the developing countries and a reluctance to proceed without them. In addition to the obvious pecuniary motives for opposing such an agreement, some LDCs fear that it will be used to restrict imports of legitimate products. Moreover, they would rather have the issue dealt with by the World Intellectual Property Organization.

Extension of GATT to New Areas

Services - The GATT framework has been limited largely to manufactured goods, while services such as banking, tourism, data processing, construction and engineering have been excluded. As a result, many service industries face import barriers more restrictive than those applied to manufactures. Despite these constraints, technological advances and the liberalization of capital markets has helped boost global trade in services to an estimated $400-$500 billion annually, approximately one-fifth of total world trade. Services account for a significant share of exports in many nations, including the LDCs (see Table 6).

Table 6: Exports of Goods and Services

(annual growth between 1973 and 1984*)

Country	Goods	Services	Share of Services**
United States	10.8%	12.5%	35%
West Germany	8.8	9.9	21
Japan	15.0	15.7	20
United Kingdom	11.2	8.5	34
France	9.0	14.7	37
Canada	11.7	10.1	13
Italy	11.5	9.3	27
Netherlands	9.6	9.6	30
Belgium-Luxembourg	9.1	15.6	38
Taiwan	18.9	18.9	14
Hong Kong	15.0	23.8	18
South Korea	20.8	21.6	24
Switzerland	12.7	12.6	30
Brazil	14.5	11.8	13
Spain	14.3	9.4	39
Singapore	22.0	17.5	27
Mexico	24.8	10.7	35
Austria	10.4	11.7	45

*In nominal terms.
**Services, including income receipts, as a share of total exports of goods and services.

Source: General Agreement on Tariffs and Trade

Some developing countries, led by Brazil and India, oppose the inclusion of services in the new round, insisting that GATT regulations should apply only to trade in goods. International rules, they argue, would permit foreign interference in sovereign areas, such as banking, a key element in development policy. Those countries that have taken protective measures to foster their own information and communications sectors use the "infant industry" argument

to oppose a code. They fear that powerful multinationals enjoying large economies of scale would destroy their service industries.

The position of the industrial countries reflects the service sector's rising importance; services now account for over 70 percent of civilian nonagricultural employment in the United States and about 60 percent of Japan's gross domestic product. As rising incomes shift consumer demand toward services in many countries, the advanced nations see great benefits in an agreement to liberalize trade in services. The developing countries would also benefit through increased investment.

The efficiency arguments that support free trade in goods apply equally to services. The world economy loses from small-scale, inefficient service industries designed to serve single-country markets. Furthermore, liberalization of trade in services will promote free trade in goods since the two are closely linked. Exports of many products depend on services, including transportation, communications, advertising, distribution and repair. The liberalization of services would not increase the exports of the industrial countries alone since there are sectors where developing countries have comparative advantages. Singapore, Hong Kong, Taiwan and South Korea, for example, are internationally competitive in such areas as shipping, financial services and construction.

Progress in the negotiating committee on services is likely to be slow given the complexity of the issues, which go beyond traditional commercial considerations and include questions of culture, privacy and national security. Domestic regulatory policies, which account for many of the nontariff barriers in services trade, are difficult to quantify and remove. Furthermore, government monopolies dominate many service industries. The lack of satisfactory data may also hinder negotiation. The congressional Office of Technology Assessment, for example, has estimated that U.S. data on service exports are about 50 percent too low.[3]

Because each service industry is different, a sector-wide agreement appears to be impractical and a series of codes may be preferable. These codes should be based on the principles of transparency and national treatment. Transparency requires open and unambiguous trade regulations -- a critical requirement since many service barriers are in the form of domestic regulations. Recognizing that it is not possible to harmonize the various national regulatory systems, governments should also agree not to discriminate against foreign suppliers of services. Lastly, an agreement should include effective dispute-settlement and enforcement procedures.

Since many service exports require foreign investment, this issue is related to the negotiations on trade-related investment issues. Currently, investment is the one international transaction for which no multilateral agreement exists. The agenda calls for discussion of restrictions on foreign investment that limit trade, such as requirements that foreign companies use a certain proportion of local materials or export a certain share of output.

Trade in Farm Commodities - This subject was generally ignored in previous rounds, leaving agriculture largely outside the GATT system. The rules that do exist are weak and ineffectual. Article 16, for example, permits

export subsidies for primary products as long as they are not used to acquire "more than an equitable share" of the market. While the major disputes in farm trade involve export subsidies and quantitative restrictions on imports, domestic farm policies are the fundamental problem.

Ironically, agricultural policies have generally encouraged the production of food in countries where obesity is a major medical problem, while discouraging it in countries where starvation remains a threat. Most advanced countries have pursued policies that are inconsistent with liberalized trade in order to achieve other goals, such as food security and income maintenance for farmers. Price supports for farm goods raise prices above world levels, thereby requiring import quotas to protect domestic producers. High prices, in turn, lead to overproduction, and encourage governments to adopt export subsidies to get rid of the surpluses. These policies have enabled the industrial economies to raise their share of world agricultural exports from about 42 percent in the early 1960s to about 63 percent in the mid-1980s, while imposing significant costs on their economies. The World Bank estimates that if the OECD countries stopped protecting agriculture, their taxpayers and consumers would save more than $100 billion a year, while farmers incomes would drop slightly more than $50 billion.[4]

The Uruguay Round will begin work on agricultural trade next month. Although the farm bloc's power in the industrialized countries makes major reforms difficult, some analysts see a window of opportunity for an agreement in late 1988, following elections in France, West Germany and the United States. Pressure from the Cairns group, a bloc of 13 agricultural exporters led by Canada and Australia, has improved prospects for an agreement. Complaining that it is caught in the middle of an agricultural trade war between the United States and the EC that has destabilized international prices, the group has threatened to boycott the new round if agricultural talks are not included.

More importantly, the spiraling costs of farm programs in the OECD countries is forcing governments to act. In the United States, the cost of agricultural programs rose from $4 billion in 1980 to a record $26 billion last year, making it the fastest-growing spending program at a time when fiscal restraint is essential. The problem is more serious in Europe, where the Common Agricultural Program has pushed the EC to the brink of bankruptcy. The cost of the CAP, which accounts for two-thirds of the EC's budget, rose to about $23 billion in 1986 as the falling dollar pushed subsidy costs higher. The EC took a first step to reduce costs when it decided last December to cut dairy production and beef price supports. But Britain and West Germany have demanded that the EC cut spending more drastically in light of an expected $5.5 billion shortfall in 1987 on top of last year's $1.5 billion deficit that the member governments refused to finance.

Japan paid out about $10.5 billion in farm subsidies in 1985. Now that the Japanese National Railways has been privatized, farms subsidies are the key to reducing the nation's budget deficit. The Ministry of Agriculture, Forestry and Fisheries places the 1986 producer price of rice in Japan at 8.3 times above the United States'. OECD figures show farm subsidies totaled almost 60 percent of the value of Japan's agricultural production, compared to the OECD average of about 33 percent.

Japan, the largest net importer of food in the world, defends its agricultural policies as necessary to maintain some degree of self-sufficiency in food supplies. Japanese self-sufficiency in terms of calories consumed is 53 percent, compared to 77 percent in West Germany, 121 percent in France and 150 percent in the United States. The country's dependence on foreign energy sources, however, limits its ability to achieve self-sufficiency in food, as a cutoff in oil imports would cripple agricultural production.

But there is a growing interest in Japan in the subject of agricultural reform. Earlier this year, two leading business organizations, Keidanren and Nikkeiren, called for an overhaul of farm policies, and the prime minister recently asked the Liberal Democratic Party to study the issue. Japan has agreed to discuss all agricultural issues at the new round, including rice, which accounts for 30 percent of the nation's farm output. Tokyo is also expected to seek at least a 5 percent cut in the price it pays farmers for rice. With agricultural policy under attack at home and abroad, farm groups seem willing to accept the cut, which would be the first in 31 years.

Export subsidies are likely to be the first topic in the Uruguay Round farm trade talks. To incorporate agriculture into the GATT framework, though, negotiations must include domestic farm policies as well. Policies that support farm income without providing incentives for overproduction are the key to reform. If a country unilaterally reduces its farm subsidies, it will lose market share. A reduction in aid to farmers would be more acceptable politically if all countries adopted reforms simultaneously. Prospects for an agreement were bolstered by last month's OECD meeting that called for a reduction in farm subsidies (see JEI Report No. 20B, May 22, 1987).

Conclusion

Given the complexity of the issues on the agenda, some analysts think the Uruguay Round could last as long as 10 years. Moreover, the diversity of interests among GATT members may make it impossible to reach a consensus on particular issues. If negotiations do not produce an agreement, Mr. Yeutter recently warned that the United States will pursue bilateral agreements, such as the free trade area negotiated between the United States and Israel in 1985.

The EC's Roy Denham has termed this approach a "step backwards that would fragment nations into a number of clubs." Many observers criticize possible FTA initiatives as a regression to the narrow, bilateral trade negotiations that characterized the 1930s. Since a FTA discriminates in favor of trade between member nations, import supplies may be diverted away from the lowest cost producer in favor of a member of the FTA.

Although multilateral trade negotiations are the most efficient method of reducing global trade barriers, there are several advantages to the FTA approach. First, it tends to reverse the usual incentives in international trade talks by making countries eager to be the first to agree to liberalize trade rather than the last. In previous rounds, countries hoarded trade barriers as bargaining chips to use in lowering other countries' barriers. With a FTA, though, each side has a reason to be the first to join in order to gain an advantage over outsiders. Second, FTA negotiations allow countries to use free trade rather than protectionism as a lever on countries reluctant to make trade

concessions. Threats of protectionism are often not credible since the country imposing the restrictions is frequently hurt as much as, or more than, the foreign country.

Multilateral trade negotiations and FTAs can be used as complementary approaches to lower trade barriers, however. Mr. Yeutter sees no problem, for instance, in participating in the new round while at the same time negotiating a FTA agreement with Canada. Moreover, if the new round breaks down, regional FTAs could be the building blocks of multilateral trade liberalization in the long run. As a FTA adds members and trade diversion mounts, the incentives for other countries to join increase.

Footnotes

[1]Costs and Benefits of Protection," OECD Observer, May 1985, pp. 18-23.

[2]World Bank, World Development Report, 1986.

[3]Office of Technology Assessment, Trade in Services: Exports and Foreign Revenues.

[4]World Bank, Op. Cit.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.